

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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In the Matter of )

Simplification of the Depreciation  
Prescription Process )FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

CC Docket No. 92-296

**Reply Comments of the Ameritech Operating Companies**

The Ameritech Operating Companies (Ameritech),<sup>1</sup> pursuant to § 1.415 of the Federal Communications Commission's (Commission) Rules, 47 C.F.R §1.415, respectfully submit these Reply Comments to the Commission's Notice of Proposed Rulemaking on Depreciation Simplification.<sup>2</sup> In these Reply Comments, Ameritech demonstrates that the arguments against simplification of the depreciation process, and in particular against the adoption of the Price Cap Carrier option, are unfounded. Specifically, they are based on misconceptions about the current depreciation process and the manner in which the proposed Price Cap Carrier option would work. Because the current process is apparently misunderstood, the Commission should reject the arguments against depreciation simplification and adopt the Price Cap Carrier option. This option provides the most public interest benefits through saving administrative time and costs while continuing to ensure that local exchange carriers (LECs) use reasonable depreciation rates.

<sup>1</sup> The Ameritech Operating Companies are: Illinois Bell Telephone Co., Indiana Bell Telephone Co., Inc., Michigan Bell Telephone Co., The Ohio Bell Telephone Co., and Wisconsin Bell, Inc.

<sup>2</sup> Simplification of the Depreciation Process, CC Dkt. No. 92-296, 8 FCC Rcd. 146 (1992) (Depreciation NPRM).

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## **I. The Depreciation Process Needs to Be Reformed**

Several parties filed comments on the Commission NPRM. All the LECs which filed comments support the Commission's effort to reform the depreciation process and recommend that the Commission adopt the Price Cap Carrier option.<sup>3</sup> These LECs recognized the need to change from the current complex and outdated depreciation process to one which will provide administrative efficiencies as well as economically rational depreciation rates.<sup>4</sup>

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and, with the advent of interconnection on May 1, 1993, competition between these companies and LECs increases exponentially. While these parties argue that the Commission should maintain its current process and closely scrutinize LECs' depreciation rates, their depreciation rates are not similarly regulated. In

current process provides a more accurate assessment of depreciation expense than other proposed methods. As noted by Deloitte & Touche, the current depreciation process focuses on historical retirement rates of equipment when the focus should be on the future useful life of the investment by considering technical obsolescence and competition.<sup>9</sup> In their comments, both Ameritech and US West demonstrate that, even though the Commission's reports require tremendously detailed data on these historical retirement rates, the Commission largely ignores the information as the basis for the prescribed depreciation rates.<sup>10</sup> Other LECs point to the significant depreciation reserve deficiency accumulated because the Commission's prescribed depreciation rates do not allow the recovery of capital investment in a timely manner, as additional evidence that the current process responds slowly to changing conditions. And if the Commission's current depreciation process continues, they state, these reserve deficiencies will only become greater as the marketplace becomes increasingly competitive.<sup>11</sup>

Commenters against depreciation reform also argue that the potential cost savings are not worth the effort. Although arguably the potential cost savings that might be achieved through depreciation reform would be a small percentage of LECs' expenses, \$30 to \$50 million dollars is still a significant amount of money. And, if changing the current depreciation process which clearly does not work efficiently would save all or a portion of these costs while still ensuring reasonable depreciation rates, it is in the public interest for the Commission to allow these savings.

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<sup>9</sup> Deloitte & Touche at 2, ¶6.

<sup>10</sup> Ameritech Comments at 2; US West Comments at 6.

<sup>11</sup> See e.g., BellSouth Comments at 15; US West Comments at 13.

It is also imperative that the Commission identify the appropriate method of determining proper depreciation rates for the interstate jurisdiction based on the construct of the interstate marketplace. State commissions make it clear in their comments that they are not required to abide by the Commission's depreciation rate prescriptions pursuant to *Louisiana Public Service Commission v. FCC*.<sup>12</sup> Rather, they emphasize their obligation and responsibility to

affects of those rates. Increasing productivity allowed LECs to significantly decrease their non-depreciation expenses through network investment even with the time lag they experienced in recovering their investment.

However, the same factors which induced LECs to invest in the network even with the inherent time lag in capital recovery are diminishing rapidly. The productivity gains available in the past cannot be continued in the future because labor has been driven down to a relatively smaller factor of cost. And, the influx of new entrants in the industry will continue to shorten the economic lives of existing technology. Finally, as competition continues to increase, the risk of not recovering capital investment similarly increases, as customers turn to private communications systems to fill their communication needs or demand the latest technology even though the existing equipment may not be fully depreciated. In fact, AT&T's capital management history subsequent to divestiture demonstrates how potentially explosive the present system is. In 1988, AT&T took a pretax charge of \$6.7 billion, for financial reporting purposes only, relating to analog equipment that had become technologically obsolete. That pretax charge was in addition to the \$7.3 billion AT&T wrote down for financial reporting purposes at divestiture. Therefore, the continuation of an outmoded process that discourages true recognition of economic cost can do nothing but discourage reinvestment in the public switch network -- which is a circumstance being promoted strongly by AT&T, MCI and others to whom LECs represent a potential competitive force.

Notwithstanding the disincentives to invest in the network caused by uneconomic depreciation rates, the study presented by the CCTA that allegedly demonstrates that LECs do not invest in the network makes an incorrect comparison. Ignoring the fact that a simple depreciation expense versus capital additions analysis cannot be used to make a valid judgement about LECs' reinvestment policies, the study mistakenly compares the annual depreciation

expense with the net additions. However, net additions are derived from subtracting retirements from gross additions. Thus, the study inappropriately nets out additions against retirements. What the study should compare is depreciation expense with gross capital additions. Using that comparison, the figures used by CCTA show that Ohio Bell invested \$20 million more than it booked for depreciation expense between 1988 through 1992. See Attachment 1. Moreover, this argument ignores the approximately \$2 billion dollars of investment in the network Ameritech makes annually. In fact, Ameritech's 1992 investment dollars were 7 percent greater than investment made in 1991 and 10 percent greater than 1988.

Based on the foregoing, it is clear there is a need to reform the depreciation process to simplify the complex and outdated depreciation process while ensuring that LECs reflect reasonable depreciation rates. Therefore the Commission should reject all arguments that the needs for simplification and economically rational depreciation rates are unnecessary.

## **II. The Commission Should Adopt the Price Cap Carrier Option**

In addition to challenging the need for depreciation reform at all, several parties also argued that the Commission should not adopt the Price Cap Carrier option outlined in the NPRM. Some parties argued that this option gives LECs too much flexibility in determining their depreciation rates, because LECs would not be required to provide cost support in its depreciation filings. With this flexibility, these commenters argue, price cap LECs would unjustifiably increase their depreciation expenses to decrease their reported rate of return in order to avoid any sharing obligation under price caps.<sup>14</sup> Conversely, other parties

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<sup>14</sup> See MCI Comments at 7; and AT&T Comments at 8-9.

argued that LECs would unjustifiably decrease their depreciation expenses in order to increase their reported rate of return.<sup>15</sup>

Several parties also argue that under the Price Cap Carrier option the Commission would be abrogating its responsibility under §220 of the Communications Act to prescribe depreciation rates. These parties claim that the Commission would merely prescribe the depreciation rates as proposed without review.

Examining these arguments based on the facts however reveals that they have no substance but are merely attempts to maintain unnecessary regulatory restrictions on LECs. First, with the increased competition in the marketplace, LECs' real interests are in using economically reasonable depreciation rates.

More importantly, there are adequate safeguards to ensure that LECs use reasonable depreciation amounts. Depreciation expenses will be prescribed on a prospective basis. Once the Commission prescribes the depreciation rates, LECs will be unable to artificially change those rates or resulting expenses. The LECs' reported rates of return are based on the actual revenues and expenses incurred during the annual monitoring period. LECs could not make year end changes to depreciation rates which would affect reported rates of return in the current monitoring period. Thus, the alleged opportunity to manipulate rate of return results does not exist. Moreover, LECs are adequately regulated by the Commission under price caps. Because depreciation expenses are considered endogenous under price caps, price cap regulation ensures that ratepayers will not be affected by the changes in depreciation rates.

There are also several additional safeguards that ensure that LECs use reasonable depreciation expenses, not the least of which is the Commission's

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<sup>15</sup>New York State Department of Public Service Comments at 3.



authority to review the LECs' proposed depreciation rates before it prescribes the rates. The Commission has ample information through their ARMIS reports to ensure that it prescribes reasonable depreciation rates under the Price Cap Carrier option. The Commission also has ample authority to request additional information regarding depreciation expenses and to take corrective action if it determines that a LEC has falsely recorded its depreciation expenses. Notwithstanding the Commission's prescription responsibilities, LECs are also constrained by financial accounting requirements under GAAP, and the Securities and Exchange Commission reporting requirements and enforcement authority.

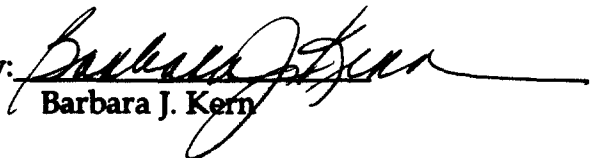
Furthermore, the Commission will not abrogate any of its responsibility under the Communications Act with the adoption of the Price Cap Carrier option. As noted above, it will still prescribe depreciation rates based on a record, and will have the ability to respond to proposed rates should they be economically imprudent.

Finally, adoption of the Price Cap Carrier option provides several public interest benefits. Because depreciation rates are most impacted by competition and technical obsolescence -- and there is substantial competition already in the interstate access marketplace -- LECs are in the best position to determine the appropriate rate of depreciation of their equipment. The Price Cap Carrier option allows LECs greater control over depreciation rates in order to use reasonable depreciation rates, pursuant to Commission review and prescription. Moreover, because depreciation rate changes do not impact the rates consumers pay, this option places the responsibility for reasonable depreciation rates where it belongs -- on the price cap carrier itself. Finally, the Price Cap Carrier option results in the most administrative savings

III. Conclusion

Based on the foregoing arguments, the arguments against depreciation reform and in particular adoption of the Price Cap Carrier option for depreciation prescription process are unfounded. Therefore, the Commission should initiate depreciation simplification and adopt the Price Cap Carrier option as proposed in its Notice of Proposed Rulemaking.

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**OHIO BELL TELEPHONE CO.  
COMPARISON OF PLANT ADDED AND DEPRECIATION EXPENSE  
(DOLLARS IN THOUSANDS)  
1988 - 1991**

<b>OHIO BELL TELEPHONE CO.</b>		
	<b>PLANT ADDED</b>	<b>DEPR. EXP.</b>
<b>1988</b>	<b>\$371,679</b>	<b>\$368,845</b>
<b>1989</b>	<b>\$359,700</b>	<b>\$337,721</b>
<b>1990</b>	<b>\$381,860</b>	<b>\$354,840</b>
<b>1991</b>	<b>\$323,300</b>	<b>\$354,917</b>
<b>TOTAL</b>	<b>\$1,436,539</b>	<b>\$1,416,123</b>

**IN 1988 - 1991 OHIO BELL TELEPHONE CO. ADDED \$1.4 B (OR \$20.4 M MORE THAN THE CORRESPONDING DEPRECIATION EXPENSE) TO DEPRECIABLE PLANT IN SERVICE.**

**SOURCES:**

Plant added to Total Depreciable Plant in Service is from year end 2A Reports.

Depreciation Expense is from STATISTICS OF COMMUNICATIONS COMMON CARRIERS (Table 2.9).